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# GREEK SOVEREIGN DEBT AND THE ROCKY ROAD TO RECOVERY

*Maria Hatalis*



## Introduction

As of July 2012, Greece is in the middle of a full-blown economic crisis, partly due to inherent flaws in economic policy and partly due to the inflexible stipulations of its membership in the European Union. Economic growth during the last decade masked the gravity of Greece's external imbalances and inefficiencies in the public sector, which were undermining its competitiveness and debt sustainability. The announcement that Greece's budget deficit was grossly underestimated (15.4 percent rather 5.1 percent) in 2009 by the newly elected PASOK government instigated a series of unprecedented interventionist actions from Eurozone members, European authorities, and the International Monetary Fund (IMF) (EEAG, p. 97). Since 2009, Greece has been battling a crisis in investor confidence that has barred it from international bond markets for over 4 years, making it impossible for the country to service its fiscal needs on its own.

As a member of the EU, Greece cannot devalue its currency, which could have improved export competitiveness, and cannot implement its own monetary policy, as the U.S. did with "quantitative easing." Thus, in order to aid the Greek government with its financing needs, the IMF, the European Central Bank (ECB), and the European Commission (EC), frequently known collectively as the "Troika," offered a bailout package of €110 billion on May 10, 2010. In return for loans that will be disbursed quarterly over a three-year period, the Greek government agreed to execute an ambitious macroeconomic adjustment plan. Fiscal austerity measures were introduced to restore public finances, while structural reforms were initiated to spur growth and increase competitiveness by means of an internal depreciation (Garcia Pascaul and Ghezzi, p. 4).

These and other measures, however, have not yet alleviated the financial situation in Greece, nor have they mollified apprehensive Eurozone members who have poured billions of

euros into loan assistance. Despite initial progress with pension and labor-market reforms, a grueling recession along with the effects of austerity measures have caused Greece to miss the fiscal targets set under the agreement with the Troika, and its deficit and debt levels remain abnormally high. As of June 2011, public debt stood at €354 billion (Tsoukalis, p. 20) and current account deficit totaled €21.1 billion (Kontogiannis, 2012). Implementation of key reforms and policies by the government, such as the privatization of public enterprises, has also lagged behind. Coupled with a flight of Greek depositors to foreign banks (equal to 20 percent of deposits since 2010) and a heavy dependence on ECB funding by Greek banks, contraction in economic activity has caused further shrinking of investor confidence (Garcia Pascaul and Ghezzi, p. 1). By fall of 2011 it was clear, based on all macroeconomic indicators, that Greece would fail to be on a sustainable path by the initial target date of June 2013, as set by the first memorandum.

Since there was neither a legal mechanism nor the will by either the European Commission or Greece for a Greek exit from EU, and since an uncontrolled Greek default would have led to further credit freeze-ups and bank runs, another €130 billion loan agreement was negotiated in October 2011. As a prerequisite for these new funds, private bond holders, such as banks, were asked to agree to a 50 percent “haircut” or write-down on private debt holdings. However, this renegotiated memorandum has not been enough to quell the uncertainty surrounding Greece’s debt sustainability as its debt burden remains significant. Greece’s track record so far has shown that fiscal consolidation together with debt restructuring are not enough to fix its insolvency and competitiveness problems. In order to put Greece on a path of debt sustainability, fiscal and structural reforms are also necessary to help promote growth and equity, but only if implemented successfully (OECD, 2011). The uncertainty of Greece’s fate continues to affect financial markets around the world, and many policymakers are worried about how the outcome in Greece will affect the crises in other peripheral Eurozone countries, such as Ireland and Portugal, where the IMF is also intervening. This issue has fuelled intense debate over whether the IMF, ECB, and EC are

responding to the crisis optimally, and whether the revised Memorandum of Understanding (as of February 2012) will help place Greece on a sustainable path by 2020.

This article explores both the debt crisis in Greece and the response taken by the IMF, ECB, and Eurozone members. Section two analyzes the factors that led Greece to the crisis, including the upsurge of public debt since entry into the European Monetary Union (EMU) and vulnerabilities in the economy that undermined its competitiveness. Section three discusses the intervention of the Troika in 2010 and the corrective measures and targets in the Memorandum of Understanding as well as the underlying rationale behind them. Section four presents the current situation in Greece and the factors that led to a worsening of Greece’s debt and failure of the first agreement. Section five then examines the second bailout package and complementary debt restructuring and discusses whether it will be enough to lead Greece on a path of debt sustainability.

The lessons learned from understanding the nature of this crisis will be useful when viewed through the lens of different Eurozone countries that have similar fiscal and solvency issues. By isolating the proximate and historical factors that influenced the development of its debt crisis, as well as how Greece attempted to deal with the solvency issue at hand, we can come to a concrete understanding of whether Greece is an isolated case among over-indebted peripheral countries in the euro area, or if it is the first in a case of a domino effect originating from a flawed system design.

## **Background: A History of Low Competitiveness and High Debt**

In May 2010, Greece entered into an agreement with the Troika that it thought would establish financial stability and restore market confidence after a decade of unsustainable economic growth and buildup of large external and fiscal imbalances. These escalating imbalances led to burgeoning twin deficits and accelerated external and public debt.

Since its entrance into the Eurozone, Greece has suffered from a large current-account deficit, signaling that imports are too high and its exports too low, and from rising

wages, despite stagnant productivity. Demand in Greece surged over the period 2000 to 2009 thanks to increases in private and public consumption and residential investment, averaging four percent of real GDP growth per year compared to two percent for the rest of the Eurozone. However, this increase in consumption has not been balanced by a complementary increase in exports. Greece's service exports, for example, which form a large portion of total exports, were heavily impacted by the global crisis. Earnings from transportation services, for example, were equal to total earnings from exports of goods in 2008. By 2009, however, earnings from transportation services had fallen by 30 percent. In addition, thirty years of heavy public expenditure, along with low real interest rates from joining the euro area in 2001 and loose budget restraints, also fueled an increase in real wages and credit growth. However, these increases in real wages were not driven by productivity gains, but were followed instead by increases in unit labor costs. Greek unit labor costs, a key metric of competitiveness, consistently followed behind that of the Eurozone.

Greece also faces a host of structural inefficiencies in its labor and product markets. For example, Greece possesses one of the strictest set of employment protection regulations in the Eurozone, making it difficult to fire employees. Low productivity coupled with low employment also compromised competitiveness. Furthermore, Greece's net national savings rate has dramatically declined since 1988 and even turned negative after adopting the euro, reflecting high rates of public and private consumption (Favaro, Li, Pradelli, and Van Doorn, 2011, p. 223). Together, this decline in the national savings rate and Greece's low external competitiveness have led to a widening of the current account deficit and increase in net foreign indebtedness since the adoption of the euro. By 2008, the current account deficit had doubled from 7 percent in 1999 (Favaro et al., 2011, p. 223) to 14 percent of GDP ("European Commission," p. 3).

In addition to these imbalances, Greece ran a costly public sector that led to accumulation of large government and external debt. Greece has a long history of using high public expenditure to fuel its economy. In particular, government spending was largely composed of

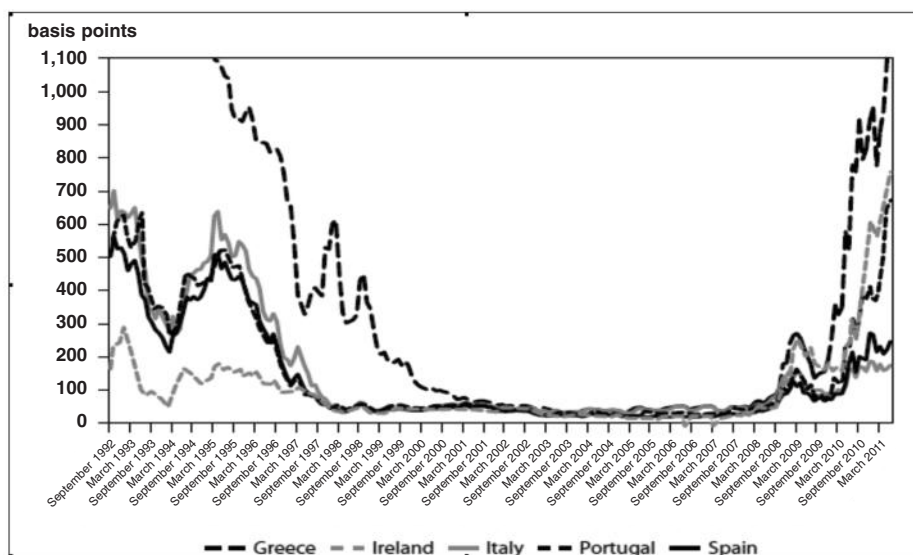
social transfers, compensation for public employees (which increased to 12.7 percent of GDP in 2009 from 8 percent in 1976) and pension benefits (11.7 percent of GDP in 2009 and expected to grow to over 19 percent by 2035) (EEAG, pp. 100–101). In fact, many public-sector positions were unionized and offered lifetime job security, thereby diminishing the incentive for employees to increase their productivity. Many of these positions also had overlapping responsibilities and were significantly fragmented. For example, there was once an instance where 13 Ministries took part in 27 tourism-related activities (McKinsey & Company, p. 20). Politicians used these “cradle to the grave” jobs as a means of decreasing unemployment and providing thousands of public sector jobs to the electorate, thereby guaranteeing re-election. By 2010, government employees accounted for 17.3 percent of total employment and their real wages were consistently higher than real wages in the private sector. Indeed, real wages of civil servants and employees in public enterprises outpaced wages in other sectors (EEAG, p. 101). This tendency to outbid private-sector wages further deteriorated competitiveness.

It comes as no surprise that such a bureaucratic system would be a center for ineffective resource utilization and delays in business operations. State-run enterprises were also ineffective and ran huge deficits. For example, total debt for the state-run railway company Hellenic Railways increased to \$13 billion, or 5 percent of GDP, in 2010 from 3 percent of GDP in 2009 (Thomas, 2010). The railway system and other public enterprises relied heavily on subsidies and borrowing from the government, and originally Greece was able to keep these liabilities<sup>1</sup> off its balance sheet. However, when Greece was forced to record these off-budget liabilities after joining the Eurozone, its debt-to-GDP greatly increased (EEAG, pp. 106–107). Moreover, this type of public spending created a sense of dependency on the government because it was directly fuelling the economy through subsidies and the creation of public-sector jobs as well as generous pensions, and indirectly through

<sup>1</sup>These liabilities came in the form of loan guarantees and “consolidation loans” and were not recorded as government debt.

**Figure 1**

# **Ten-year interest-rate spreads over German Bunds, September 1992–June 2011**



Source: Tsoukalis, Loukas. "Greece in the Euro Area: Odd Man Out or Precursor of Things to Come?" p. 21.

lax tax enforcement and obstructions to industry. By 2009 the size of the government had grown from 44 percent in 2000 to 50 percent of GDP ("European Commission," pp. 3–4). To make matters worse, Greece is plagued with widespread tax evasion (mostly income and payroll taxes) and serious inefficiencies in tax collection, which reduced government revenue (EEAG, p. 104). By 2009 government revenue in Greece fell to 37 percent from 43 percent in 2000 (EEAG, p. 102).

Rather than seeking to lessen its debt load during good times, the Greek government continued to boost spending to finance its burgeoning public sector and borrow to finance its debt, facilitated by low interest rates since the adoption of the euro. Indeed, since Greece was under the protective umbrella of the Eurozone, borrowing costs remained low since yields were slow to react to rising deficits and because deficit debt limit enforcement was weak under the Stability and Growth Pact.<sup>2</sup> By 2009, however, total government debt increased from 103

percent of GDP in 2000 to 115 percent of GDP and net external debt rose from 45 percent in 2000 to almost 100 percent of GDP ("European Commission," p. 6). In addition, Greece's negative net international position rose to 98 percent of GDP by 2010 (EEAG, p. 8).

The onset of the global financial crisis in 2007 highlighted these imbalances in Greece, especially as revised estimates of the budget deficit were made public. The high levels of public and external debt led investors to re-evaluate the risk premium associated with Greece. Among the many concerns was Greece's budget deficit, an astonishingly high 15 percent of GDP in 2009. This figure is in sharp contrast to the budget deficits for other troubled countries such as Portugal and Italy, which were 9.3 percent and 5.3 percent respectively in 2009 (Cabral, 2010). Seeing that a significant portion of Greece's public debt was also held externally, implying that each interest payment paid to non-domestic creditors was detrimental, Greece's perceived ability to service its debt worsened. As seen in Figure 1, this concern led to a surge in yield spreads of EU members' 10-year sovereign-bond issues with respect to the German bund. Risk premiums, especially for

<sup>2</sup>Under the Stability and Growth Pact, member state's annual budget deficit can be no higher than 3% of GDP and national debt should be lower than 60% of GDP.

Greece and other beleaguered peripheral EU members, rose as investors flocked to assets that were perceived to be of lower risk (such as the German bund), thereby making it exceedingly costly for Greece and other indebted countries to borrow from debt markets (Gómez-Puiga and Sosvilla-Rivero, p. 7). The idea that Greece might default turned into a self-fulfilling prophecy as downgrades from leading rating agencies, as well as increases in credit-default spreads, boosted borrowing costs further, thus making it impossible for Greece to finance its considerable fiscal needs. Unable to tap into international financial markets, Greece could no longer roll over its debt as it had done before the crisis. Thus, in order to prevent a sovereign default with a heavy contagion risk, Eurozone leaders had no choice but to provide coordinated loans to Greece with the help of the IMF.

## Intervention of the IMF/ECB/EC

As of May 2010, Greece was in a three-year stand-by arrangement (SBA) with total planned disbursements from the EU and IMF of €110 billion, which were meant to cover Greece's financing needs until 2013 (EEAG, p. 110). Eurozone countries contributed €80 billion in bilateral loans to this finance package, while the IMF provided a €30 billion loan. As a condition of accepting this assistance, which is provided in quarterly installments, Greece must adhere to strict conditionality requirements as outlined in a Memorandum of Understanding. This conditionality agreement relies on a series of fiscal consolidation measures and structural reforms aimed at restoring fiscal solvency, restoring competitiveness through an internal depreciation, and creating a healthy environment for long-term growth (Garcia Pascaul and Ghezzi, p. 4).

One of the primary objectives of the aforementioned plan<sup>3</sup> was to reduce the Greek budget deficit to below 3 percent of GDP by 2014, from 13.6 percent in 2009 (Nelson, Belkin, and Mix, p. 4). To this end, fiscal austerity measures, such as public spending cuts and indirect tax increases, were implemented aiming to allay the net increase in public debt and secure

medium- and long-term fiscal sustainability ("European Commission," p. 10). The programme also called for structural fiscal reforms in the pension system (e.g., cutting retirement age and reducing benefits), public administration, healthcare (e.g., decreasing public health expenditure to or below 6 percent of GDP), and steps to prevent tax evasion. Other measures taken include: cuts in nominal wages and pensions (including abolishing the 13th and 14th monthly payments), public investment, and subsidies to public enterprises; and increases in value added tax and excise duties on tobacco and alcohol. Even though fiscal consolidation was necessary to bring Greece's public finances and deficit under control, there is a concern that such efforts could greatly exacerbate the ongoing recession and lead to further unemployment at a time when economic growth is essential.

Indeed, the idea of employing contractionary fiscal policies during a time of severe recession is counterintuitive, which begs the question of how long the Greek government can pursue such policies before public support fades completely (Nelson et al., p. 9). As a member of the Eurozone Greece cannot depreciate its currency to adjust its trade deficit, nor can it engage in independent monetary policy. Thus, the only remaining tools available to Greek policymakers are to bring their public finances in line by reducing the number of public-sector jobs, salaries, benefits, and demand for private-sector goods. This set of actions will lead to repercussions in the private sector since aggregate demand falls, thus forcing down wages, incomes, and prices further (EEAG, p. 118). Ideally, prices of domestic goods and services will fall in proportion with income. With higher prices for imports, Greece's exports will become more affordable and thus more competitive. This theoretical boost in exports and reduction in imports would lead to a reduction in Greece's current-account deficit (EEAG, p. 118). However, contrary to an external depreciation, whereby Greece's currency falls immediately, an internal depreciation takes time since prices and wages are sticky downwards in the short term (i.e. it takes time for prices to fall). Thus, until prices react according to changing economic conditions, there will be a real contraction in the economy as it faces falling

<sup>3</sup>Known as the Economic Adjustment Programme.



incomes and rising unemployment. Even if wages and prices do fall eventually to bring about a reduction in the deficit, an internal depreciation leaves Greece's external debt burden unchanged. In a period of recession where incomes and GDP are falling, an internal devaluation could trap Greece's indebted economy in a vicious cycle in which its debt-to-GDP ratio rises because debtors must pay the same interest payments with lower incomes (Krugman, 2011).

Indeed, there is a concern that these fiscal consolidation efforts will do little to stop Greece's ratio of foreign debt to GDP from increasing (EEAG, p. 118). This concern stems from the fact that most Greek debt during the onset of the crisis was held by foreign investors (79 percent of government gross debt in 2009), which means that each interest payment made to non-domestic residents makes Greece poorer as money leaves the country. This situation differs from countries such as Italy, for example, where the majority of debt was held internally, interest payments were made within the country, and thus wealth did not leak out of the country. Without a significant debt restructuring, interest payments would have continued to accumulate and cut into GDP. Moreover, fiscal austerity measures would have hindered nominal GDP growth, resulting in a worsening of Greece's external indebtedness (Cabral, 2010).

Perhaps in light of the aforementioned risks accompanied by fiscal consolidation efforts, structural reforms were also introduced and geared toward increasing Greece's productivity and competitiveness in the long term and re-launching economic growth in order to boost investor confidence. Critical reform areas, as noted by the IMF's Deputy Managing Director, included "second-stage labor market reforms, opening of closed professions, and deregulation of tourism and retail trade" ("IMF Completes . . ."). In the first year, Greece successfully managed to pass several structural reforms for correcting labor-market rigidities and improving labor-market flexibility, especially in the service sector. One critical reform, for instance, included the liberalization of over 108 closed professions such as pharmacists, notaries, and truckers (Kaskarelis, 2012). Goals were also set to increase flexibility in the labor

market by reducing hiring and firing costs, and allowing firm-level employment contracts. Reforms were also undertaken to restructure Greece's healthcare and tax systems, streamline local government administration, and "establish monitoring mechanisms for enhanced financial supervision" (Kaskarelis, 2012). There seemed to be a general consensus among the public in 2010 that unpopular measures such as pay cuts and reduction of employee benefits and severance packages were a necessary evil for Greece to regain its balance (SKAI, 2011). Another key area of reform was the privatization of state-owned enterprises, such as Greece's Public Power Corporation (PPC) and other state-owned assets, in order to decrease government expenses. Reforms were also emphasized in simplifying start-up and licensing procedures for businesses and approval processes for large investments.

This was a crucial time for Greece to prove to investors that it could pass a series of austerity measures and fundamental reforms in order to demonstrate its commitment to resolving its crisis and ensure long-term economic sustainability. Greece has already made considerable headway towards such reforms, but it seems that the pace of reform is diminishing. This slowdown is happening for a number of reasons, including: a widening of Greek bond interest spreads that is dampening investor confidence and jeopardizing deficit reduction plans, increased uncertainty regarding Euro member support amidst domestic political tensions, doubt regarding the sustainability of the IMF/ECB/EC's program, and domestic social pressure due to rising unemployment.

Additional support of €130 billion was committed to Greece in early 2012, when Euro-zone leaders deemed Greece to be in need of further assistance in light of its deepening recession (Ahearn, Jackson, Mix, and Nelson, p. 14). The aid package differed from the May 2010 package in that it decreased interest burdens, extended maturities, increased the use of EU funds aimed at structural reforms, and included a private sector involvement in the haircut of Greek debt (Tsoukalis, pp. 26–27). The idea of private-sector involvement—albeit voluntary—raised fear that such a move would be deemed a default by credit agencies, and spreads on Greek bonds increased twofold.

## How Did the Memorandum of Understanding of 2010 Fail?

While 2010 was a productive year for Greece in terms of implementing the IMF's mandates, 2011 was fraught with more obstacles. Even though the Greek government achieved a five percent reduction in its deficit in 2010 ("From May 2010 to May 2011"), it failed to meet its fiscal targets for 2011 and was often criticized for lacking the political will to implement structural reforms and favoring more front-loaded tax hikes instead. Indeed, fiscal consolidation measures in 2011 were comprised of 60 percent tax increases and 40 percent reductions in spending (Provopoulos). These tax measures, for example, included increases in VAT rates, multiple special levies on profitable firms, and large increases in tax rates on real estate (Visvizi, p. 192). Tax hikes negatively affect investment, as companies face lower after-tax returns, and after-tax disposable income falls, which drives down domestic consumption. Reductions in government spending have also been largely focused on cutting back public-sector investment and subsidies, which hampers economic growth. Greece has faced immense difficulty in trying to orchestrate a reduction in the number of public sector employees and it has been slow and inefficient in its implementation of structural reforms that it agreed to make (e.g., tax evasion and privatization), thus further decreasing the programme's efficacy. The governor of the Bank of Greece, George Provopolous, also points to the fact that fiscal consolidation in Greece has led to a larger economic contraction than in either Ireland or Portugal because Greece is a relatively closed economy. In other words, demand for Greece's exports from abroad is very low and imports are also relatively low, thus recession negatively impacts domestic products and services more than imports.

Together, these problems have led to a greater economic contraction, worsening of market sentiment, and increased insolvency in the banking sector. The deficit in 2011 was over 10 percent ("Greece: Request for . . . , p. 5), much higher than the IMF's original SBA projections, due to a "deeper than expected recession" with the economy shrinking by 5 percent instead of the 3.8 percent estimated by

the EU and IMF in June (Nellas). In addition, real GDP has declined by more than 13 percent since 2009, significantly overshooting SBA projections ("IMF Completes . . . , p. 5). Greece's previous finance minister Evangelos Venizelos argues that the larger European context should also be taken into account when trying to understand Greece's inability to re-enter financial markets and its failure to meet fiscal targets, claiming that Spain, Portugal, and Italy have since acquired similar unsustainable debt loads of their own. Indeed, more Euro-zone banks are also being downgraded by rating agencies and facing shortages in liquidity, and governments across Europe are facing similar challenges in trying to attract investors for their sovereign bonds.

Furthermore, the feeble progress of reform has not improved investor sentiment and, according to IMF reports, "reform momentum has not gained the critical mass necessary to begin transforming the investment climate" ("Statement by . . ."), indicating that investor confidence still remains low at a time when Greece could greatly use more foreign direct investment. Goals for privatization have fallen slightly to the wayside due to uncertainty in the valuation of state-owned assets and because of more depressed market conditions, implying that the government will receive lower revenues than expected ("Statement by . . ."). Given this slow pace of reform, a plan to raise €50 billion from privatization of state-owned assets by 2015 was decreased to €35 billion by 2014 ("Statement by . . ."). In addition, current Greek legislation, including the introduction of new taxes such as Papandreou's property tax, and further wage and pension cuts, have also prompted social discontent and led to nationwide strikes, a stark difference in public sentiment from 2009. Credit within Greece also continues to tighten as deposit withdrawals increase, and as more depositors are heading toward banks in other EMU countries (Tsafos, *Greek Default Watch*, 2011). Furthermore, overall progress for structural reforms has been shaky despite initial progress in regulated professions and licensing procedures. IMF officials claim that a "reinvigoration of reforms remains the overarching challenge" ("Statement by . . .") for Greek policymakers as they strive to push past public disapproval.



On the whole, the IMF's bailout plan of implementing drastic spending cuts and structural reforms to reduce Greece's deficit and debt burden has fallen short. Since 2009, these austerity measures were initially resisted by Parliament because of the fear that they would slow growth raise unemployment, and impose a large deflationary effect on the Greek stagnant economy. In reality, the bailout plan has not caused these effects; rather, they were already prevalent in an uncompetitive and unproductive economy. What the bailout has done, however, is magnify the downturn in the Greek economy by forcing the Greek government to implement severe fiscal austerity measures that decrease disposable income through heavy taxation and wage and pension cuts. Admittedly, some of these cuts are nevertheless necessary, especially in Greece's public sector. The bailout also mandates structural reform that, if implemented properly, may increase the effectiveness and competitiveness of the Greek economy. With a slowdown in the pace of reform, however, and an increase in new measures to bring down the deficit, the Greek government is focusing more on short-term solutions rather than long-term sustainability. It is no wonder that the Greek government and the bailout plan are often pointed to as the root cause of much of the public's discontent. The current difficulties facing Greece have also led to a political impasse in the Greek government and in Europe, where further action has been delayed, and threats have been made to withhold further bailout funds to Greece unless it takes more decisive actions.

Since February 2012, plans have been set for another €130 billion of further financing, along with Greece's debt restructuring, and two European stabilization mechanisms known as the European Financial Stability Facility (EFSF) and European Stability Mechanism (ESM) have been established and funded ("About EFSF"). A new treaty for greater fiscal regulation and consolidation, known as the Fiscal Compact, has also been formulated. However, there are still concerns over whether the EFSF and ESM, despite their increased lending capacity, are sufficient to deal with both the Eurozone's endangered banking sector and its highly indebted members. What remains to be seen is whether successful structural reforms will be

implemented and how long it will take Greece to repay its debt without defaulting. Greece must persuade the markets that it can not only pass reform laws but also implement them without causing excessive social upheaval. If Greece is successful in these reforms, the country can slowly regain investors' confidence and achieve growth through the gradual return of foreign investment. More importantly, the relative success of the IMF's programs in Greece will not only determine the turnaround of its deteriorating economy, but it will also surely set a precedent for other struggling economies such as Spain, Ireland, Portugal, and Italy.

## **Second Agreement; Will it Work?**

In early 2012, two years after the original May 2010 agreement and four years of recessionary economic activity, it was clear that Greece was not going to be able to access international capital markets by 2013 as the original programme envisioned. The new bailout agreement, voted on and agreed to by EU finance ministers and EU policymakers in February 2012, included considerable debt restructuring along with substantial new bailout funds of €130 billion. The main features of the program included a voluntary agreement with the private sector to restructure national debt and a larger emphasis on internal devaluation and "growth-enhancing" structural reforms as the way to spur growth. Indeed, the most recent IMF staff report on Greece highlights that "resolving Greece's balance-of-payments problem within the euro will require a shift in the structural-reform strategy to directly prioritize internal devaluation."

As a part of the debt restructuring with the private sector, orderly write-downs meant that Greek bonds lost relatively 75 percent of their economic value (Taylor), but Greece's outstanding debt stock fell by €107 billion. This "haircut" will help bring down Greece's debt burden as a proportion of GDP from its peak of 164 percent to 120 percent by 2020 ("The Euro Crisis . . ."). In addition, Greece will receive €28 billion from the IMF, which will be disbursed in 17 installments of €1.65 billion, with the last payment made in 2016. Members of the euro area will provide €144.7 billion, which will not need to be repaid before 2016 ("Greece: Request

for . . .”). Moreover, Greece’s official creditors agreed to reduce the interest rate for the loans disbursed under the first Greek bailout program, thereby reducing Greece’s cost of servicing its debt by an estimated 1.4 billion (“The Euro Crisis . . .”). By 2014, the goal is to have the public sector own 69 percent of Greece’s public debt, which is a significant transference of ownership from the private sector. Seeing that there is no need to repay its loans before 2016, it seems that Greece has been given some much-needed breathing space to service its debt. Indeed, the IMF loans will not need to be repaid until 2026, and the Eurozone loans will likely come due at a much later date.

Nevertheless, concern still runs high that, despite the debt restructuring and lax debt repayment schedule, the IMF’s stand-by agreement seems overly optimistic in its hopes for an internal devaluation. Even if such a devaluation does occur, Greece still faces unsustainable debt levels that could also undermine the goals and policy targets of the programme. Policy targets and estimates for the Greek economy do indeed seem optimistic: GDP is expected to decline by 4.8 percent in 2012 before turning positive in 2014; the government is forecasted to run a deficit in 2012 before running surpluses by 2013; and the debt-to-GDP ratio is meant to fall from 163 percent of GDP in 2012 to 116.5 percent of GDP by 2020 (“Greece: Request for . . .”). The IMF forecasts that private consumption in 2012 will fall by 5.7 percent, followed by a smaller contraction of 1.1 percent in 2013 and modest growth thereafter (Tsafos, *Greek Default Watch*, 2011). Exports are also projected to increase by a 7 percent yearly average from 2013 to 2016. However, since exports fell by 20 percent in 2009 and grew by only three percent in 2010, it is difficult to imagine export growth doubling in the forthcoming year unless there is a significant overhaul in reform measures or other developments (e.g., productivity growth) that support exports (“Hellenic National Reform . . .”). Furthermore, the IMF forecasts a 7.7 percent growth in investment from 2013 to 2016 (Tsafos, “The Day After . . .”). In order for this to happen, structural reforms affecting the business environment need to be efficiently implemented.

Essentially, these forecasted changes—the fall in consumption, followed by increases in

export growth and investment—follow the scenario of an internal depreciation that aims to boost external competitiveness and long-term growth. However, the IMF forecasts seem to rely heavily on the rapid growth of exports and investment, and on several unpredictable factors, including the Greek government’s ability to implement and follow through with the structural reforms it legislates. Even the IMF acknowledges that “restoring competitiveness by way of internal devaluation has proved to be a difficult undertaking with very few successes.” There is also the risk that an internal depreciation will lead to a deeper recession (especially if Greece falls behind on the aforementioned forecasts). Faced with falling incomes, yet increasing debt load thanks to these new loans, Greece could once again stray from its debt trajectory (i.e. 120 percent debt-to-GDP ratio by 2020) and plunge itself further into recession. The result would be another failed bailout program, or the need for further bailout loans in the future.

In addition to the difficulties of achieving an internal devaluation, another problematic factor that could forestall Greece’s path to financial sustainability is public opinion. The issue of whether an internal devaluation can be achieved is also an issue that is inexorably tied to the interaction of the Greek government and the public. Beset with rising anti-austerity sentiment on the one hand and a struggling bureaucracy on the other, it is no wonder that public opinion swayed against the two dominant parties during the elections on May 6, 2012 and again on June 17, 2012. Once the dominant parties for over 30 years, PASOK (the leading socialist party) and New Democracy (the main conservative party) barely managed to receive enough votes in the June 2012 election to form a governing coalition (Donadio and Kitsantonis, 2012). New Prime Minister Antonis Samaras was compelled to form a three-party coalition government with the newcomer Democratic Left Party to prevent another election where SYRIZA, a coalition of leftist parties who are not in favor of the current bailout agreement, might have won. The current fragmentation of the political system parallels public sentiment about the failure of the first memorandum and the ensuing recession. Greece’s gross national product declined 20 per-

cent since 2009 and unemployment is at an agonizing 21 percent and rising. Meanwhile, promised labor reforms and privatization targets still have not been efficiently implemented. Seeing that Greece ranks 119th on the Heritage Foundation-Wall Street Journal's Index of Economic Freedom (which places Greece lower than many sub-Saharan countries), it is also clear that Greece faces a large problem when it comes to adhering to the "basic economic principles of good economic policy" (Taylor).

With the growing recognition that the Greek government lacks the confidence of its people, the government must now convince the public, and itself, that it can follow through with the task at hand. If the coalition government fails to pass the legislature necessary to carry out the reforms outlined in the memorandum, it would not only lose to its rival, SYRIZA, but also put Greece in contempt of the Troika agreement. Both of these outcomes could lead to expulsion of Greece from the Eurozone. It would thus be in Greece's best interest to persevere on the path that the IMF has set out for it and continue to implement reforms that address the main problems of underlying competitiveness and economic productivity rather than look towards easy solutions such as tax hikes and spending cuts, or even worse, an exit from the Eurozone. With a recessionary

economy and high unemployment, Greece can no longer afford to delay measures that are needed to spur growth. With the rise in anti-austerity sentiment, the government can use this period as an opportunity to turn a new page and focus on growth-enhancing structural reforms. To pursue these reforms successfully, the government needs to communicate effectively to the public the importance of these reforms in order to build a sustainable economic foundation that will help steer the country out of its debt crisis. While the elections in May and June of 2012 exemplified public frustration, they also paved the way for new political strategies and a move away from the old clientelistic tendencies of the old government. If there is willingness in the Greek Parliament to be open to new political ideas, then the current uncertainty associated with the collapse of the dominant political forces in Greece may simply be an opportunity in disguise. Time is running out, however, and the tables are now turning on Spain and Italy, who are currently facing ailing banking sectors, alarmingly high bond yields, and escalating debt levels. The Greek government must take decisive action before its golden thread of life, like so many tragic figures in Greek mythology, is also cut prematurely by the fates.

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